COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts	)	D.T.E. 01-20

VERIZON MASSACHUSETTS' REPLY BRIEF ON RECONSIDERATION ISSUES

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INTRODUCTION

The Department has requested that the parties supplement the record in order to enable the Department to reconsider critical assumptions regarding the appropriate discounts for switching equipment, right to use ("RTU") fees and DC power cable lengths.

In order to apply its interpretation of TELRIC consistently, the Department should increase Verizon MA's RTU fees in order to capture the amount of RTU costs that would be incurred in an environment that assumes that virtually all switching investment is "dropped in place" at "new"' equipment discount levels. Neither AT&T nor WorldCom ("CLECs") have effectively refuted Verizon MA's claims that a consistent and fair application of TELRIC requires the Department to recognize that complete initial and ongoing RTU fees should be recovered in under Department's "dropped in place" TELRIC construct.

Likewise, AT&T and WorldCom offer no new arguments to support their claims that isolated "bid" information, which represents minute portions of Verizon MA's total switch

investment, should be assumed to be representative of the per line costs that Verizon MA could be expected to pay to purchase all of the switching investment necessary to serve the entire demand for the Commonwealth. The CLECs' claims are not supported by actual investment information and are based upon unreasonable assumptions regarding switch vendor pricing.

The CLECs' criticisms of Verizon MA's alternative "life-cycle" type approaches for evaluating the mix of digital switch equipment likely to be purchased as "new" and "growth" equipment are equally invalid. The Verizon MA methodologies are founded on actual experiences over an extended period of time and assess the manner in which digital switch equipment purchases are likely to evolve in the long-run. In contrast, the CLECs selectively disregard actual data and advocate a "snapshot" approach that is based on a single, speculative growth projection applied mechanically over the life of switching investment.

AT&T/WorldCom's criticisms of Verizon MA's proposed DC power cable lengths are likewise off base. They first claim incorrectly that the Department ordered Verizon MA to produce additional evidence to support its proposed cable lengths. To the contrary, in its September 24 Order on Reconsideration Issues, the Department noted that Verizon MA had supported its proposed cable lengths with an extensive survey and directed *the CLECs* to respond to this evidence. Indeed, the Department found that in the initial case, the CLECs wholly failed to produce any evidence of their own regarding power cable lengths, choosing instead to rely on the cable lengths adopted by the Texas Commission in an entirely different proceeding involving a different ILEC.

AT&T also argues that Verizon MA's proposed cable lengths should be disregarded because Verizon MA failed to adjust its actual cable lengths to make them forward-looking and because they are generally longer than the cable lengths from Verizon MA's own equipment to

BDFBs. As Verizon MA demonstrated in its Initial Brief on Reconsideration Issues, providing power to collocators is fundamentally different from providing power to Verizon MA equipment, due in large part to the CLECs' demands for large amounts of floor space and extra cable slack. Verizon MA also demonstrated that its actual cable lengths are representative of forward-looking cable lengths.

Finally, AT&T asserts that Verizon MA's Power Distribution rate element recovers cabling costs that are also recovered in the Power Consumption rate element. AT&T's complaint boils down to a rate-design dispute, not an issue of double recovery. As Verizon MA explained in its Initial Brief on Reconsideration Issues, it chose for administrative convenience to *blend*, in the Power Consumption rate element, the relevant costs associated with providing power to CLEC equipment cabled to Verizon MA's BDFBs with the costs associated with providing power to CLEC equipment cabled directly back to the power plant. This overall blended Power Consumption rate is lower than otherwise appropriate for CLECs that are cabled to BDFBs; thus, the fact that a CLEC that is cabled directly to the power plant contributes to the costs of cables connecting BDFBs to the power plant does not mean that Verizon MA is double recovering costs.

ARGUMENT

I. THE DEPARTMENT SHOULD REJECT THE SWITCH DISCOUNT PROPOSALS OF THE CLECS.

A. The Switch Discounts Adopted by the Department Should Be the Effective Discount Proposed by Verizon MA for Lucent Equipment and the Current Contract Discount for Nortel Equipment.

As the Department recognized in its July 11, 2002 Order, the switch vendor equipment discount assumption used in the SCIS cost model is a fundamental decision that affects the switch material prices that form the basis of the Department's determination of the forward-

looking switch investment level necessary to provide unbundled network elements ("UNEs") throughout the Commonwealth. *Order*, at 298. In order to prepare a reasonable estimate of the "discounted" switch material prices that an Incumbent Local Exchange Carrier ("ILEC") could be expected to pay to purchase switch equipment to serve the entire demand in Massachusetts, the Department should have adopted the "effective" switch equipment discount that Verizon MA proposed.

Verizon MA's cost study incorporated a forward-looking discount for switch equipment from Lucent based on an analysis of Verizon East's actual switching equipment purchases during 2000. Exh. VZ-36, at 152-153; Exh. VZ-38A, at 59-60. The analysis produced an overall "effective" discount that recognized that certain equipment is subject to different discounts and that those discounts may differ depending on whether the purchased equipment is considered "growth" or "new." Because Verizon's switch equipment contract with Nortel contains a single discount regardless of whether the equipment is "new" or "growth," Verizon MA's cost study utilized the Nortel contract discount for Nortel equipment.

In its post-hearing brief, AT&T alleges that Verizon MA has effectively abandoned its original discount proposal. AT&T Initial Brief [Reconsideration], at 18. AT&T is wrong. On reconsideration, the Department requested that the parties provide supplemental information regarding Nortel equipment purchases. *September 24 Order,* at 13. The Department did not advise the parties that it intended to hear re-argument on switch discount issues raised previously. Thus, in this reconsideration proceeding, Verizon MA limited its testimony and argument to addressing the significance of the supplemental information requested by the Department. Verizon MA has never wavered from its contention that the appropriate discount

for Lucent equipment is the effective discount set forth in Verizon MA's analysis of actual purchase information.

As a result of the Department's decision to assume that 90 percent of new switch equipment could be purchased at "new" discount levels, rather than to adopt Verizon MA's effective discount analysis, the Department has substantially understated the forward-looking costs of purchasing sufficient switching equipment to serve the Commonwealth.

Ironically, AT&T and Worldcom now argue that the switch discount should be based on what it alleges Verizon "actually pays" for switching equipment. AT&T Initial Brief [Reconsideration], at 1-3. What Verizon "actually pays," or could reasonably be expected to pay if it were to reconstruct its network, is precisely what is captured by the "effective" discount methodology advocated by Verizon MA. The "costs" that AT&T *alleges* Verizon actually pays are based entirely on AT&T's interpretation of isolated bid information from 1998 that, at best, represents a miniscule portion of Verizon's switch investment.[1/] Reliance upon such a small percentage of "actual" switch equipment purchases requires a willful disregard of the fact that the context in which the 1998 bids were submitted by the vendors was a pricing scheme in which the majority of switch equipment sales were made at "growth" discounts. Exh. VZ-60, at 12-14. The limited bid information that the CLECs rely upon cannot reasonably be extrapolated to formulate conclusions regarding the prices vendors would charge for "new" equipment in a hypothetical market environment that assumes that the current primary vehicle for vendors to recover their costs, *i.e.*, growth discount sales, would be jettisoned.

[1/] AT&T's per-line "cost" estimate does not represent the actual cost that Verizon incurred for the switches that AT&T cites to support its position. The AT&T "costs" are understated because they do not include all costs, such as those associated with EF&I and software.

As discussed below, the CLECs' position that selected Nortel switch bid information is "representative" of the prices that Verizon MA could be expected to pay for switch equipment — even if the current switch market were to take a 180 degree turn resulting in the majority of equipment being sold as "new" — is unreasonable and does not result in a meaningful estimate of TELRIC-compliant forward-looking costs.

The appropriate forward-looking discount assumption for Nortel equipment is the "new" equipment discount level that is set forth in the current Verizon/Nortel contract, entered into in December 2001. Exh. VZ-36, at 152-153; Exh. VZ-38A, at 59-60. That contract discount level represents the price at which Nortel has agreed to make new switch equipment available when it is ordered by Verizon regardless of Nortel's level of interest in supplying that equipment when it is ordered. Thus those resulting contract prices are far different from the prices that may be available under specific bids where the circumstances of the vendor and the particular job determine the price at which the vendor is then willing to make the equipment available.

AT&T/WorldCom witness Pitts alleged that certain bids by Nortel evidence a purposeful decision by Nortel to not offer a price that would enable it to win the bid. Exh. ATT-32, at 3. The logical conclusion from Nortel's inability to win these bids is that Nortel determined that it could not — or that it was not in its economic interest — to offer a lower price under the circumstances associated with the bid. A vendor has the ability to control its prices during the bidding process for whatever reason it deems appropriate (*e.g.*, inability to deliver an extraordinarily large volume of equipment). Thus, Verizon is able to purchase equipment only at those bid prices that are offered under the limited circumstances applicable to each bid. Under the Nortel/Verizon contract however, Nortel is obligated to provide new switch equipment at the negotiated contract rate — based on the needs of Verizon.

AT&T claims that Verizon MA's opposition to the use of competitive bid data to estimate switching costs is inconsistent with its assertion that actual cost data is relevant to the determination of forward-looking costs. AT&T Initial Brief [Reconsideration], at 10-11. The claim is baseless. Indeed, AT&T alleges that Verizon MA used actual cost data for outside plant equipment assumptions, but did not suggest that higher prices should be assumed because of the increased demand contemplated by TELRIC. But Verizon MA's position on switch investment is not inconsistent with its recommendations regarding outside plant material costs. Indeed, Verizon MA is the only party to this proceeding that has advocated the use of *complete* actual switching cost information to estimate forward looking costs.

For components of its outside plant equipment, Verizon MA's cost study estimates equipment costs based on actual purchases, adjusted to be forward-looking. Exh. VZ-36, at 21-22. These cost estimates include various size orders for equipment and material and reflect the fact that the per-unit price for some purchases may be less than, or greater than, others. For switching equipment, Verizon MA evaluated its actual discounted purchases and determined the effective discount provided by the vendor for all of its switch equipment sales. This methodology yields a meaningful measure of the true discount because it captures the complete vendor/customer pricing relationship. A vendor does not care if equipment is purchased at a "growth" discount or a "new" discount, provided that at the end of the day the vendor realizes the same revenue.

The CLECs, by failing to recognize how the majority of switch investment is actually incurred, are advancing inconsistent positions regarding the use of "actual" equipment prices. To be consistent, the CLECs would have had to argue that the Department must assume that Verizon MA could purchase all of its outside plant equipment at once and that vendors would

provide astronomical discounts for such an extraordinary volume purchase. At a minimum, the CLECs would have had to argue that the lowest unit price ever paid by Verizon for any piece of outside plant equipment should be the only piece of cost information ever considered for that equipment, and, further, that the price should be assumed to be available on a scale sufficient to serve the entire demand. Instead, the CLECs and the Department advanced the position that actual material cost information from all jobs should be considered to establish a per-unit material cost that reasonably reflects actual costs. Those unit prices are then adjusted to be forward-looking and that adjustment does not include an astronomical discount based on an unrealistic assumption that the entire amount of material to reconstruct the network could be purchased (and presumably delivered) all at once. That same reasoned position should be applied to switch purchases.

B. The Selective Reliance of AT&T Upon Isolated Bid Information That Represents Only a Fraction of the Verizon Total Switch Equipment Investment In Order To Estimate the Total Switch Investment Necessary To Serve Massachusetts Is Both Unreasonable and Inconsistent With TELRIC.

Notwithstanding the fact that the Department's assumption that 90 percent of equipment could be purchased at the "new" discount level, thereby resulting in the understatement of forward-looking switch investment, the CLECs urge the Department to reduce its switch cost study assumptions further by adopting excessive and egregious "new" switch discounts based upon bid information from Nortel. AT&T Initial Brief [Reconsideration] at 12-13; WorldCom Initial Brief [Reconsideration] at 7-8. The discounts proposed by the CLECs do not reasonably reflect the "discounts" that Verizon MA could expect to be offered for the purchase of all of the switching equipment necessary to meet its entire demand.

In its post-hearing brief, Verizon MA explained that the total switch investment recommendations of AT&T are not validated by any real world experience because they

represent only a fraction of the actual investment incurred by Verizon MA to provide switching. Verizon MA Initial Brief [Reconsideration] at 13-15. For example, the total switch investment recommended by AT&T and WorldCom — to replace all of Verizon MA's existing switch facilities — is *only 4 percent* of Verizon MA's actual booked digital switch equipment investment. *See* Verizon MA Initial Brief [Reconsideration], at 15. Furthermore, the entire amount of investment identified by AT&T to replace all of the **[VERIZON MA PROPRIETARY BEGINS]** ** **[VERIZON MA PROPRIETARY ENDS]** Nortel switches in Massachusetts (including the capacity for the next three years worth of growth) is approximately *one-half* of the amount that Verizon MA estimates it may spend over the next three years simply to add growth equipment to existing Nortel switches in Massachusetts. Exh. VZ-61, at 10.

Moreover, in its July 11, 2002 Order, the Department recognized the vast majority of switch equipment purchases are made at the growth discount pricing. *Order* at 302-304. Indeed, the Department noted that in the year 2000, of all of the Lucent switches throughout Verizon East's service territory, *only two new switches* were purchased and the vast majority of equipment was purchased at the growth discount. *Order* at 304. Similarly, the Department found that for 1998, 99.7 percent of Verizon's investment in Lucent equipment was made at "growth" discount prices. *Id.* at 305.

Disregarding the undisputed fact that switch equipment purchased at "new" discount prices constitutes a mere fraction of Verizon's actual switch equipment purchases and switch vendor sales, the CLECs argue that the total forward-looking cost for switch investment necessary to serve the entire Commonwealth should be based upon "prices" in two 1998 bids from Nortel because that is "what Verizon actually pays" for switch equipment.[2/] AT&T Initial

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[2/] The price-per-line information from bids should not influence the adoption of a discount assumption for the SCIS model. In fact, such an end result approach undermines the value of the SCIS model and the fact that

Brief [Reconsideration] at 1-3; WorldCom Initial Brief [Reconsideration] at 8. The CLECs' contention that isolated 1998 bid information can be extrapolated to propose a reasonable estimate of the prices that a switch vendor would offer to replace the entire network is premised upon AT&T's one-sided view of TELRIC — hypothesizing that all switches must be "replaced" and then using selected "actual" pricing information based upon market conditions and pricing strategies that are totally at odds with the entire network replacement hypothesis.[3/]

AT&T apparently hopes to convince the Department to ignore the overall context in which bid prices (particularly the two 1998 bids that AT&T relies upon) are offered. The reality is different. Switch vendors recover their costs for switching equipment primarily through the sales of equipment at "growth" discount levels. This pricing scheme — one that requires vendors to recover their cost of goods sold regardless of whether their equipment sales are labeled "new" or "growth," is premised upon the majority of current sales (including sales in 1998) being based upon "growth" discounts. Furthermore, the digital switch equipment market is fully penetrated due to the fact that current digital equipment is nearing the end of the product's life cycle. Vendors are able to offer that equipment at highly discounted prices, knowing that "growth" sales will eventually result. In 2000, throughout its entire region, Verizon purchased a total of six "new" switches at approximately **[VERIZON MA**

SCIS is used to identify the unique switch investment appropriate for Verizon MA. Thus, the Department should focus its efforts on establishing an appropriate discount; not a price per line. That discount can then be used in the SCIS model to estimate the forward-looking costs for switching equipment based upon the unique characteristics of each wire center in Massachusetts.

3/ Worldcom also alleges that correspondence from Verizon to switch vendors urging vendors to submit low per line bid estimates supports WorldCom's claim that it is reasonable to assume that Verizon MA's entire network could be purchased at discount levels that would result in a fraction of Verizon MA's actual investment. The letter cited by Worldcom merely reflects Verizon's ongoing attempt to secure the lowest possible prices for switch equipment. It does not support the conclusion that vendors would be willing to extend discount levels in certain bids involving minimal amounts of equipment to all of the equipment necessary to replace all of Verizon MA's switching investment.

PROPRIETARY BEGINS] ********* **[VERIZON MA PROPRIETARY ENDS]**. During that same period throughout the entire Verizon region, Verizon expended approximately **[VERIZON MA PROPRIETARY BEGINS]** ********** **[VERIZON MA PROPRIETARY ENDS]** for switching equipment. Exh. VZ-61, at 9.

It is clear that the prices identified by AT&T in the so-called "competitive bids" are incremental prices available because large portions of the costs for the earlier generations of these switches have already been paid by Verizon. These bids were also priced in light of the profit that the switch vendors were making on the growth sales being made at the time. Under the hypothetical proposed, no growth sales would be made during the three-year planning cycle in which the switches were "dropped in place." If the only switch equipment sales made during this period were new switches, the vendors would be forced to price these new switches such that they made the same profit on the new switches that they currently are making on the new and growth sales.

Moreover, the current digital switches available and being offered through the "competitive bids" represent the end of a technological cycle. Exh. VZ-60 at 10-11. For this reason, too, the demand for these switches is very small and this limited demand affects current pricing strategies.

Under the TELRIC "dropped in place hypothesis," however, the demand for the present generation of Nortel or Lucent digital switches would be artificially stimulated to exponential proportions. Instead of a full network of operating digital switches, the "dropped in place" hypothesis requires the Department to assume a sudden comprehensive demand for 130 digital switches. The immediate need for so many new switches would totally reverse the actual low market demand for a new digital switch at the end of a technological cycle.

C. The Nortel Discounts That AT&T Relies Upon Are Not Representative of Recent Nortel Pricing Proposals — Much Less Representative of the Per-Line Cost To Reconstruct an Entire Network.

Contrary to the CLECs' assertions, the two 1998 Nortel bids (Chester, PA and Eastwick, PA) are not representative of prices offered currently or regularly by Nortel — even for the limited amount of "new" equipment that Nortel is providing in the existing saturated digital switch market. Indeed, the record demonstrates plainly that AT&T and WorldCom's assertion that new switch prices are steadily declining is invalid.[4/] WorldCom Initial Brief [Reconsideration] at 7; AT&T Initial Brief [Reconsideration] at 9). More recent Nortel bid information – although not relevant to establishing forward-looking costs, because, among other things, it represents such a small portion of annual switch investment — shows that the reported Nortel per line bids for bids submitted in 2001 are **[VERIZON MA PROPRIETARY BEGINS]** $**********[5/] **[VERIZON MA PROPRIETARY ENDS]** and that the per line cost for the Pearl Street, New York switch purchased from Nortel is **[VERIZON MA PROPRIETARY BEGINS]** *******[6/] **[VERIZON MA PROPRIETARY ENDS]**.[7/] This data results in an average per line cost, more than 450 percent of AT&T's claimed figure.

Thus, there is no factual support for the CLECs' assertions that 1998 Nortel bids are "representative" of actual current bid information — much less the prices that a company could

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4/ WorldCom mistakenly asserts that Ms. Pitts "presented discount data on 16 different Nortel switch installations." WorldCom Initial Brief [Reconsideration], at 9. However, only three of the switches in Ms Pitts' "analysis" referred to by WorldCom were for Nortel equipment and for three of the locations (Hull St., Granby St., and Petersburg) new switches were not installed. WorldCom Initial Brief [Reconsideration] at 9; RR-DTE-103.

5/ RR-DTE-103, Attachment.

6/ *See* Pearl Street documents, Exh. ATT-VZ-31-1.

7/ The per-line costs identified in the bids do not contain all of the costs associated with purchasing particular switches because they do not include such things as complete EF&I and RTU fees.

be expected to pay if demand for new switches increased exponentially, as called for in the TELRIC hypothesis.

AT&T also tries to extend its unreasonable position regarding discounts and per line costs for Nortel equipment to Lucent equipment. AT&T Initial Brief [Reconsideration] at 12. Apparently recognizing that it cannot get the AT&T "new" equipment prices lower than they are because the Department has already utilized Lucent bid discount information to establish the "new" discount for Lucent equipment, AT&T tries to apply Nortel's isolated "price" offerings to Lucent by implying that the Department should suddenly ignore the Lucent equipment prices and bid data that it has already considered and assume Nortel "costs" control and that the Lucent equipment costs must be "roughly" the same. The Department has already determined that it is reasonable for Verizon to purchase switch equipment from multiple vendors. *Order*, at 303-304. AT&T's attempts to circumvent the effect of Verizon's multiple-vendor purchasing strategy is unreasonable and should be denied.

II. SUBSTANTIAL EVIDENCE IN THE RECORD SUPPORTS THE CONCLUSION THAT THE DEPARTMENT SHOULD INCREASE RTU FEES FOR "NEW" SWITCH EQUIPMENT.

Because the Department has: (1) determined that under a "dropped in place" TELRIC assumption, 90 percent of the equipment in Verizon MA's cost study should be assumed to be purchased at the "new" discount level; and (2) made no adjustment in its determination of RTU fees as contained in Verizon MA's cost studies, the Department has understated the forward-looking costs for RTU fees. The RTU fees in Verizon MA's studies do not include the "initial" RTU fees that would be incurred if Verizon MA were required to "replace" its entire network

from scratch — as assumed by the Department's "dropped in place" TELRIC construct. Exh. VZ-60, at 2-6; Tr. 20, at 3722, 3763-3764].[8/]

As explained by Verizon MA witness Joseph Gansert,[9/] RTU fees are paid by Verizon through software buyout agreements in which Verizon effectively prepays for software rights pertinent to future "new" switches. Exh. VZ–60, at 3-4; Tr. 20, at 3720-3711. Thus, the RTU fees incurred at the time when the recent switches referenced by AT&T were purchased are substantially reduced from what they necessarily would have been if buyouts had not occurred. Accordingly, in order to determine the amount of RTU fees that would be incurred in an environment where *no* prior buyout agreements or vendor/company prior contract relationships exist, it is necessary to estimate the average initial RTU fees that would be charged for each new switch. Contrary to the CLECs' claims, substantial evidence has been produced in this proceeding to show that the cost of $1.88 million per switch in initial RTU fees recommended by Verizon MA is reasonable and supported in the record. *See* Verizon MA Initial Brief [Reconsideration] at 7-10.

In its brief, AT&T ignores the fact — admitted by its own witness (Tr. 20, at 3775) — that pre-existing buyout arrangements reduce the amount of RTU fees that are paid when switches are purchased through competitive bids. Instead, AT&T argues that Lucent charges only "small" or "no" fees because "switch vendors long ago fully recovered their software costs" — presumably through buyouts and prior sales of switch equipment. AT&T Initial Brief [Reconsideration] at 14. This assertion that "forward-looking" software costs should not be

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8/ Because the Verizon MA cost study did not assume the majority of switch equipment would be purchased at the "new" switch discount level, the study included only "ongoing" RTU fees that are incurred on a regular basis in order to maintain and upgrade switch software. Exh. VZ-60, at 2-3.

9/ The pre-filed testimony of Thomas Mazziotti that was adopted by Joseph Gansert is referred to as the Gansert testimony.

considered (despite the extraordinary value of that software) because they constitute "embedded" or pre-existing purchases is directly at odds with the TELRIC requirement precluding the consideration of embedded investment. The CLECs want the Department to embrace an inconsistent cost approach that assumes that RTU fees are close to non-existent, and at the same time disregard the fact that those artificially low costs exist only as a result of embedded costs. This one-sided approach, enabling the CLECs to have the benefit of the "all new" TELRIC hypothesis while disregarding the necessary corollary that the hypothesis would have to include buyout arrangements on pre-paid software in the forward-looking costs, is inconsistent and unfair. Simply put, the study assumption used for hardware and software must be in sync. The CLECs' assertions that Verizon MA's hardware costs must be based on new equipment without regard to the embedded base of equipment, while at the same time advancing the concept that lower software prices should be used in recognition of what was paid for as part of that embedded base, should be rejected.

AT&T's assertion that the valuable Lucent software marketed to Verizon has " no cost" or only a "very small" cost cannot be reconciled with the record evidence. First, the RTU cost information provided to Verizon by Lucent is fully reasonable, (*see* Verizon MA Initial Brief [Reconsideration] at 8-9) and was provided by Lucent specifically to answer the question at hand — *i.e.*, to estimate RTU fees where equipment is purchased outside of pre-existing buyouts. The Lucent analysis shows that the per switch RTU fees that would apply in a situation where there were no prior agreements affecting RTU costs, would be **[VERIZON MA PROPRIETARY BEGINS]** ********** **[VERIZON MA PROPRIETARY ENDS]** per switch. Exh. VZ-60, at 5. Lucent's analysis is corroborated by AT&T's own contract with Lucent, in which AT&T has agreed — and in fact committed — to pay **[AT&T**

PROPRIETARY BEGINS] ******* **[AT&T PROPRIETARY ENDS]** to upgrade certain 5ESS switches and **[AT&T PROPRIETARY BEGINS]** ******* **[AT&T PROPRIETARY ENDS]** per switch in RTU fees to upgrade its 5ES switches from 5ES12 to 5ES13. Exh. VZ-ATT/WC 3-1, Exhibit 1, attachment A; *see also* Exhibits 4 and 5. AT&T's claim that there are "no software" costs for Lucent 5 ESS switches is thus totally at odds with its own purchasing practices.

For Nortel equipment, the CLECs take a different approach, dismissing certain bid data originating from Nortel and actual costs paid by Verizon to Nortel as "non-probative." AT&T Initial Brief [Reconsideration] at 14. For example, AT&T dismisses the relevance of initial RTU fee proposals by Nortel of **[VERIZON MA PROPRIETARY BEGINS]** ******* ********** **[VERIZON MA PROPRIETARY ENDS]**[10/] by invoking the logical fallacy that the bids are meaningless because Verizon didn't accept them and instead awarded bids to Lucent for those locations. Likewise, AT&T dismisses the fact that Verizon paid to Nortel **[VERIZON MA PROPRIETARY BEGINS]** ********** **[VERIZON MA PROPRIETARY ENDS]**[11/] because that switch replacement was done on short notice. AT&T Initial Brief [Reconsideration] at 14. The Pearl Street price, however, more realistically identifies a TELRIC price because it demonstrates the price that would be charged where there is *immediate demand* for switching equipment and a supplier can dictate the terms under which it chooses to offer its equipment.

[10/] Exh. VZ-60 at 4.

[11/] Exh. VZ-60 at 4

In addition, AT&T ignores the impact of pre-existing software buyouts for Nortel switches in an "analysis" that it alleges reflects initial RTU fees paid to Nortel. AT&T Initial Brief [Reconsideration] at 15.[12/] That "analysis," however, does not consider the fact that what it classifies as "initial RTU fees" have been reduced by pre-existing buyout arrangements.

Lastly, AT&T concludes that the RTU fees that Verizon pays for software when it buys new switches through competitive bidding show that Verizon's RTU factor in its cost study should be reduced. AT&T's "analysis" of selective switch bids is invalid because, among other things, it: (1) excludes certain selected actual bid information; (2) ignores the fact that initial RTU fees in bids do not reflect complete initial RTU fees because of pre-payments; and (3) fails to recognize that the "initial" RTU fees reflected in the bids are in addition to the ongoing RTU fees that are in Verizon MA's cost study.

Likewise, WorldCom's claim that Verizon MA's request that initial RTU fees be incorporated into the cost study adopted by the Department should be denied because the "evidence provided by Verizon during discovery" shows that RTUs are "already recovered" in the switch material cost estimate, is without merit. WorldCom Initial Brief [Reconsideration] at 3. WorldCom's assertion that RTU fees are "already" in the per-line investment results from the Verizon MA cost model adopted by the Department is based upon a misunderstanding of the SCIS Model and obvious confusion between switch bid information and material investment results from the SCIS Model.

12/ AT&T's "analysis" is set forth in Tab 1 of its brief. Tab 1 contains references to three switches that were not purchased by Verizon (Granby Street, Hull Street and Petersberg) and excludes a switch purchased for Massachusetts (Franklin Street) because AT&T alleges that the cost per line is "unusually high". AT&T Initial Brief [Reconsideration], Tab 1, 3. *See* RR-DTE-103. AT&T's decision to exclude Franklin Street from its analysis is typical of AT&T's selective exclusion of information that is contrary to its position.

The per-line bid information that was provided in discovery was not used by Verizon MA to develop the switch investment from SCIS. The per-line investment results from the SCIS Model are based upon the application of a discount assumption to the list prices in the SCIS model. Thus, the SCIS model produces a discounted material only investment figure. Additional costs, such as EF&I and RTU fees, are then added to the switch material calculation from SCIS. To the extent that bid information may contain certain RTU costs, those costs are not captured in the material investment results from the SCIS model. Therefore, there is no "double recovery." WorldCom Initial Brief [Reconsideration] at 4.

Furthermore, WorldCom's assertion that the bid information contains RTU costs is misleading. As discussed above, because RTU fees are regularly paid for through software buyout arrangements for future switches purchases, the prices paid for "new" switches do not generally reflect the complete cost of RTU fees for that switch.

In order to capture RTU fees properly that would exist in the TELRIC construct adopted by the Department, it is necessary that the Department adjust the RTUs fees in Verizon MA's cost study to reflect the additional average initial RTU fee of $1.88 million per switch.

III. THE 90/10 "NEW" TO "GROWTH" EQUIPMENT DISCOUNT RATIO ADOPTED BY THE DEPARTMENT AND ADVOCATED BY THE CLECS RESULTS IN AN UNDERSTATEMENT OF FORWARD-LOOKING SWITCH COSTS.

The Department's assumption that 90 percent of Verizon MA's entire switch investment could be purchased at the "new" switch discount rate that has historically been available for only a small portion of switch equipment purchases results in an understatement of forward-looking costs. There is no reasonable basis to conclude that the discount level that has at times been made available for a small portion of total equipment sales would automatically be made available for the majority of such sales. If the majority of switch equipment were to be sold as

"new," vendors would be required to modify their discount strategies simply in order to be made whole.

In the event the Department does not reconsider its "new" to "growth" ratio and adopt instead Verizon MA's effective discount, the Department should revise its ratio to more accurately reflect the manner in which digital equipment is purchased. The life-cycle-type approaches recommended by Verizon MA more accurately reflect the manner in which digital equipment is likely to be purchased than does the 90/10 ratio advocated by the CLECs. Exh. VZ-60, at 9-12; Exh. VZ-61, at 6-10. The CLECs' recommendation is premised upon an entirely speculative growth assumption applied mechanically over the depreciated life of a switch.

The analysis submitted by Verizon MA in RR-DTE-66, on the other hand, captures five years of data and provides meaningful information about the evolution of a substantial portion of Verizon's digital switch equipment network. The ratio of "new" to "growth" equipment for that period is 50/50. Exh. VZ-60, at 9.

In response to the Department's request, Verizon MA completed an even more detailed analysis of equipment purchases that reflects a mix of new and growth purchases over a 12-year period (1990-2001). Exh. VZ-60, at 12. That analysis reveals that 65 percent of equipment over that period was purchased as "new" and the remaining 35 percent as "growth."

AT&T alleges that Verizon MA's long-term analysis understates "growth" equipment because it ignores "spare capacity" that was installed with new switch purchases. AT&T Initial Brief [Reconsideration] at 18. Even if AT&T's criticism were true — which it is not — the process of including growth equipment in new switches does not have a material effect on the result. For example, if one were to assume three years of growth at 2.5 percent per year, the ratio would change from 65.07:34.93 to 66.74:33.26. *See* Attachment 1, hereto.

AT&T's allegation that Verizon MA's analysis is not "long enough," is also invalid. AT&T Initial Brief [Reconsideration] at 18-19. The 12-year analysis conducted by Verizon MA captures substantial portions of Verizon's digital equipment purchases and reflects virtually the full-life depreciation of switch assets. This extended analysis by Verizon MA provides much more reliable information than the speculative, "one-year snapshot" advocated by AT&T. Verizon MA's five-year and 12-year analyses each better reflects how costs for digital switching equipment are incurred in the long run. Accordingly, if the Department does not adopt the effective discount proposed by Verizon MA, the Department should reject its 90/10 ratio and should adopt the ratio determined in either the five-year or the 12-year analyses submitted by Verizon MA.

IV. THE AT&T RE-ARGUMENT REGARDING THE EF&I FACTOR SHOULD BE STRICKEN

AT&T's post-hearing brief goes beyond the scope of the limited issues that the Department directed the parties to address. Specifically, in response to Verizon MA's August 14, 2002 Motion for Reconsideration, AT&T now advocates that a "new" EF&I factor be adopted by the Department. AT&T Initial Brief [Reconsideration], at 11. The Department is currently considering Verizon MA's motion and has not directed the parties to provide supplemental information regarding EF&I. It is inappropriate for AT&T to "brief" this issue, and Verizon MA respectfully requests that section of AT&T's brief addressing EF&I be stricken.

If the Department does decide to consider AT&T's new claim regarding EF&I, it must reject AT&T's position on its merits. Remarkably, AT&T alleges that EF&I on a per-line basis *should decrease* if the Department were to decrease switch investment. AT&T Initial Brief [Reconsideration] at 11-12. AT&T's position is without merit, contrary to common sense, and record evidence demonstrating that EF&I dollar costs do not change simply because a particular

equipment price changes. Exh. VZ-38A, at 75. Exh. ATT-27, at 14-16. There is no reasonable basis to assume that, in the event the equipment material prices were to decline, there would be a corresponding and proportionate reduction in the engineering, installation and furnishing labor costs associated with that equipment. To the contrary, as equipment prices go down, the ratio of the EF&I costs to the equipment costs necessarily increases.

V. THE DEPARTMENT SHOULD ADOPT THE POWER CABLE LENGTHS PROPOSED BY VERIZON MA.

AT&T and WorldCom fail to credibly attack Verizon MA's proposed cable lengths, arguing: (1) Verizon MA was required to provide additional evidence to support its proposed cable lengths; (2) the cable lengths are not forward-looking and are discriminatory; and (3) Verizon MA is double recovering cable costs. As discussed below, AT&T/WorldCom's claims are without merit and should be dismissed.

A. The Department Did Not Order Verizon MA To Provide Additional Evidence To Support Its Proposed Cable Lengths.

AT&T and WorldCom fundamentally misunderstand the Department's Order on Reconsideration, arguing that Verizon MA's proposed cable lengths should be rejected because Verizon MA failed to "come forward with *additional* evidence or explanation" (WorldCom Initial Brief [Reconsideration] at 10 (emphasis added)) and that "Verizon has failed to meet its burden of proof on this issue" because Verizon MA did not "provide any *additional* support for its proposed [cable lengths]." AT&T Initial Brief [Reconsideration] at 21 (emphasis added). Contrary to AT&T/WorldCom's claims, the Department did *not* find that the evidence supporting Verizon MA's power cable lengths was deficient or needed to be supplemented. Rather, the Department reopened this proceeding because it concluded that "the Department's treatment of the issue of the appropriate cable length [was] affected by Verizon's perhaps

incorrect statements on the record and failed to address other contradictory evidence of record." *September 24 Order* at 17. The Department therefore ordered further evidentiary hearings so that "the Department and other parties [would] have the opportunity *to examine the support for Verizon's original [proposal]*." *September 24 Order* at 17-18 (emphasis added).

Moreover, as Verizon MA noted in its Initial Brief, the Department has already found Verizon MA's cable length survey to be reliable. Verizon MA Initial Brief [Reconsideration] at 18; *Order* at 425-426. In contrast, the Department held that AT&T "d[id] not present any specific evidence to support its recommendation" concerning cable lengths, "but merely point[ed] to a Texas PUC decision" setting cable lengths for a different rate element and involving a different incumbent carrier. *Order* at 425. AT&T's attempt to remedy this deficiency — through the testimony of Mr. Turner — falls short of the mark, for the reasons Verizon MA explained in its Initial Brief. *See* Verizon MA Initial Brief [Reconsideration] at 18-28.

B. The Cable Lengths Proposed by Verizon MA Are TELRIC-Compliant.

AT&T further claims that Verizon MA's proposed cable lengths are not forward-looking because they reflect the actual lengths of the power cables provisioned to collocation arrangements in 2000. As Ms. Clark explained, Verizon MA's proposed cable lengths are forward-looking and TELRIC-compliant; there is no reason to believe — and no evidence in the record to suggest — that the cable lengths in a completely redesigned central office would differ materially from the cable lengths in Verizon MA's cost study. *See* Verizon MA Initial Brief [Reconsideration] at 26.

As an initial matter, AT&T incorrectly asserts that Verizon MA's proposed cable lengths were derived from "70 collocation jobs." AT&T Initial Brief [Reconsideration] at 21, 22. To support that assertion, AT&T inexplicably points to Ms. Clark and Mr. Gushue's Rebuttal

Testimony on Reconsideration,[13/] which explained: "the power cable lengths were based on an examination of about *70 percent* of the collocation jobs (representing *over 500* work orders) performed during 2000 that required the placement of power cables for CLECs' use." Exh. VZ-62, at 15 (emphasis added). Ms. Clark also made this clear in her May 4, 2001 Direct Testimony. Exh. VZ-28, at 21.

AT&T also incorrectly claims that TELRIC requires "building a central office from the ground up." AT&T Initial Brief [Reconsideration] at 26. TELRIC requires no such thing. The Department has found "that the FCC's TELRIC principles require us to assume existing CO locations *and structures*, but with efficiently reconfigured interior layouts."[14/] *Order* at 385 (emphasis added). Nor would Verizon MA's proposed cable lengths be materially different if the interior of Verizon MA's central offices were redesigned. Verizon MA Initial Brief [Reconsideration] at 26. Even assuming that the location of the collocation area *could* change (and AT&T offered no evidence to support this point despite having access to floor plans), the cabling distance between the CLEC's equipment and the BDFB/power plant would not materially change, particularly when the BDFB is located in the collocation room, as is often the case. *Id.*

AT&T's assertion that Verizon MA's cabling practices must be discriminatory because the distances between Verizon MA's own equipment and the BDFB/power plant are shorter than the distances between the CLEC's equipment and the BDFB/power plant is equally misplaced. AT&T Initial Brief [Reconsideration] at 24-27. To support that claim, AT&T cites to inaccurate

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13/ AT&T also questionably relies on pages 3584 and 3585 of transcript volume 19 to support its assertion that Verizon surveyed 70 collocation jobs. *See* Tr. 19, at 3584-3585. But on page 3583, AT&T's attorney correctly asked Ms. Clark whether Verizon MA examined *"70 percent* of the collocation jobs performed during the year 2000 that required placement of cables for CLEC use?" *Id*., at 3583 (emphasis added).

14/ Verizon MA does not agree that TELRIC requires that the interior of the central offices be redesigned.

and misleading figures,[15/] but does not even attempt to address the unavoidable and non-discriminatory reasons for these discrepancies explained by Mr. Gushue and Ms. Clark in their testimony and at the hearings. *See* Exh. VZ-62, at 10-11, n.4; Tr. 19, at 3601-3602. For example, as Verizon MA explained, the cabling distances from a collocator to the BDFB/power plant are generally longer because, unlike Verizon MA's own equipment lineups, the CLECs' equipment is placed throughout the collocation room, due in part to the CLECs' demands for large amounts of floor space. Verizon MA Initial Brief [Reconsideration] at 22-25. Although Mr. Turner conceded that these facts make providing power to collocators different from providing power to Verizon MA's own equipment (Tr. 19, at 3628-3629), AT&T fails to address these realities in its brief.

C. Verizon MA Does Not Double Recover Cable Costs.

Unable to seriously contest either the data or the analysis relied on by Verizon MA in offering its proposed DC power distribution cable lengths, AT&T attempts to engage the Department in a cost recovery shell game. AT&T argues that a CLEC that is cabled directly to the power plant pays for the cabling between the BDFB and the power plant two times: once in the Power Consumption rate element, and once in the Power Distribution rate element, which recovers the costs for the entire length of the cable from the CLEC's equipment to the power plant. AT&T Initial Brief [Reconsideration] at 27-29; Exh. ATT-30-P, at 6-7.

As Verizon MA explained in its Initial Brief, AT&T is really complaining about Verizon MA's rate design, not that Verizon MA is double recovering costs. Verizon MA Initial Brief

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[15/] For example, AT&T claims that "[f]loor plans for three Verizon Massachusetts central offices in metro density zones show that the average cable distance between a BDFB and Verizon's equipment is approximately 50 feet." AT&T Initial Brief [Reconsideration] at 24 (italics omitted). Importantly, it is not possible to calculate cable racking or cabling distances from the floor plans provided to Mr. Turner in Exhibit ATT-VZ 30-6, because those diagrams do not show cable racks.

[Reconsideration] at 26-28. Because Verizon MA assumes cabling from BDFBs to the power plant only 95 percent of time,[16/] the Power Consumption rate element for those CLECs' that are cabled to BDFBs is lower than otherwise appropriate. And while it is correct that cables terminating directly to the power plant are billed at the same Power Consumption rate as those terminated to BDFBs, it is not correct to conclude that Verizon MA is double recovering costs.

Nor is it correct to conclude that the Power Distribution rate element should also be weighted using the same 95 percent assumption. At most, the Department should "unblend" the Power Consumption rate element ? a solution that Mr. Turner acknowledges would resolve his concerns.[17/] Exh. ATT-30-P, at 7.

CONCLUSION

For the foregoing reasons Verizon MA respectfully requests that the Department issue an Order: (1) increasing the RTU fees in Verizon MA's cost study to include $1.88 million per switch for initial RTU fees; (2) modifying its discount assumption by adopting the effective discount proposed by Verizon MA, or adopting one of the "life-cycle" type approaches submitted by Verizon MA; (3) rejecting AT&T's request that the Department further reduce

16/ This weighting factor is not proprietary.

17/ Notably, AT&T proposes that the Department adopt *all-gauge* average cable lengths, thereby using the shorter cables of those CLECs that cable to Verizon MA BDFBs to offset the longer cables used by AT&T to cable directly to the power plant, reducing the Power Distribution rate AT&T would otherwise have to pay. AT&T plainly wants to have its cake and eat it too ? AT&T advocates for both a blended rate (Power Distribution) and an unblended rate (Power Consumption), depending which benefits AT&T the most.

switch discount levels based upon information from Nortel bid submissions; and (4) adopting Verizon MA's proposed gauge-by-gauge cable lengths used to calculate Verizon MA's Power Distribution rate element.

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